

**FOR  
INFORMATION**

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To: Members of the Executive Board

From: The Secretary

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Coordination Instrument**

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**\*At the time of circulation of this paper to the Board, the authorities have indicated that they need more time to consider whether they will consent to the Fund's publication of this paper. Publication will only proceed upon the receipt by the Fund of the member's explicit consent.**





# SEYCHELLES

## INTERIM PERFORMANCE UPDATE UNDER THE POLICY COORDINATION INSTRUMENT

August 3, 2020

### EXECUTIVE SUMMARY

**Context.** COVID-19 has had a severe economic impact on Seychelles through the implementation of strict domestic measures to contain the spread of the virus and the related global spillovers. The authorities have responded with measures to mitigate the economic fallout on businesses and households. To help address the urgent balance of payments need arising from the pandemic, the Executive Board approved on May 8, 2020 the authorities' request for emergency financing under the Rapid Financing Instrument (RFI) of SDR 22.9 million, equivalent to 100 percent of quota (IMF Country Report No. 20/170).

**Summary.** This document is for information only. Performance under the program had been strong until end-2019 and four reviews under the PCI were concluded on time. However, some downside risks to the outlook have materialized. The COVID-19 pandemic continues to batter the economy; perspectives for tourism and thus the growth outlook have deteriorated further. In addition to the measures discussed in the RFI request, the authorities have continued to roll out additional social and economic measures to support households and firms during and beyond the lockdown. Given the large uncertainty around the near-term outlook, in part related to rapidly adapting travel restrictions, and policy making, the 5<sup>th</sup> review under the PCI cannot be completed within the three-month grace period of the scheduled review date (July 31, 2020). This document updates the Executive Board of the latest economic developments and program performance under the PCI.

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## RECENT ECONOMIC DEVELOPMENTS

**1. The pandemic continues to take a toll on Seychelles' economy.** Given Seychelles' heavy dependence on tourism, the pandemic has had a severe impact on the economy. The deployment of strict domestic containment measures<sup>1</sup> and global travel restrictions have deteriorated the fiscal and external positions as 2020 tourism receipts are expected to fall by 64 percent compared to 2019. To help address the urgent balance of payments (BOP) need arising from the pandemic, the Executive Board approved on May 8, 2020, the authorities' request for emergency financing under the Rapid Financing Instrument (RFI) of SDR 22.9 million, equivalent to 100 percent of quota. The authorities have successfully prevented a local outbreak<sup>2</sup> and are gradually reopening the border to tourists. On June 1, the country started allowing passenger flights, thus far limited to chartered flights. Some commercial flights from low-risk countries are expected to be allowed from August 1, 2020. In addition to fiscal mitigation measures, effective of July 1, the Central Bank of Seychelles (CBS) cut the policy rate by 100 basis points. Market reaction to this policy action has been muted. Nominal exchange rates have been stable since late May while inflation has been contained so far.

**2. High downside risks to the outlook are materializing.** The near-term economic outlook has worsened as the global economic downturn is expected to be deeper and travel restrictions to persist longer than expected at the time of the RFI request (Country Report No. 20/170, Tables 1–5). The worse global economic outlook for 2020 is expected to reduce tourist arrivals in Seychelles by about two thirds in 2020, compared with a 50 percent decline anticipated in May 2020.<sup>3</sup> Hence, economic activity is now projected to decline by almost 14 percent in 2020 (compared with a previously projected contraction of almost 11 percent). The authorities concur with the revised outlook and as economic growth is expected to fall more sharply, they have taken further measures to mitigate the impact on affected businesses and vulnerable households, and fiscal needs and revenue loss have become larger. The growth effect is expected to further reduce fiscal revenue by about 1¼ percent of GDP in 2020 compared with the projection at the time of the RFI request. The authorities reformed the wage subsidy measures by extending the duration of the program but revising its coverage, thereby maintaining the nominal cap of spending on wage subsidies at the level envisaged at the time of the RFI request (5¼ percent of GDP in 2020). At the same time, the authorities intend to increase the execution of capital expenditures in 2020 by about 1¼ percent of GDP to bolster domestic demand. As a result, the primary deficit is expected to reach 12¼ percent of GDP in 2020 while the debt-to-GDP ratio would increase to about 90 percent by end-2020, due to a widening of the fiscal deficit and a further depreciation of Seychelles rupee since late April. The

<sup>1</sup> The government took decisive containment measures, including entry ban, school closures, and mandatory work from home for all non-essential workers.

<sup>2</sup> Although the Seychelles reported no new cases since mid-April and all 11 positive cases (no deaths) recovered by early May, 70 sailors from Western African countries tested positive after arriving in Seychelles to join a fleet of Spanish tuna fishing boats in late June. Mandatory work-from-home was lifted on April 30. On May 18, all schools were reopened.

<sup>3</sup> Although the global assumptions in the June 2020 World Economic Outlook (WEO) update still indicate that major advanced and emerging markets, which are the main tourism markets for Seychelles, will start a significant recovery in 2020Q3, it will likely take some time for the confidence of tourists to return to pre-pandemic levels.

current account deficit is expected to reach about 27 percent of GDP in 2020, slightly lower than expected at the time of the RFI as imports declined more than expected. External financing needs for 2020 are expected to be covered by IFI (about \$55 million by the World Bank and African Development Bank), notably RFI financing (\$31 million) and a reduction of the gross international reserves (GIR) which is expected to decline to slightly below 100 percent of the Fund's standard reserve adequacy (ARA) metric at end-2020.

**3. Downside risks remain substantial.** The medium-term outlook is contingent on resumption of tourism and capital flows to Seychelles. In line with the June 2020 WEO global projection updates, staff assumes that global tourism demand will rebound from 2021 onwards and the number of tourist arrivals in Seychelles would return to the level of 2019 by 2025. With the recovery in tourism and accompanying investments, real GDP growth is expected to reach 4¼ percent in 2021 and 5½ percent in 2022, and gradually moderate to around 4 percent over the medium term, in line with staff's estimates of the potential growth rate in Seychelles. This will lead to a rebound in fiscal revenue and help improve the fiscal position over the medium term. A more protracted normalization of the global economy or resurgence of the pandemic would delay the economic recovery or further deepen the slump.

## PROGRAM ISSUES

**4. Performance under the program had been strong until the onset of the economic fallout of the pandemic.** The first four reviews under the PCI were concluded on time. All end-December 2019 quantitative targets (QTs) for the 5<sup>th</sup> review were met: the floors on the primary fiscal surplus and net international reserves (NIR) at end-December 2019 were both exceeded by comfortable margins (Table 2). The 12-month average inflation rate at end-2019 was well within the inner bound of the monetary policy consultation clause (MPCC). The authorities have not imposed any foreign exchange restriction in line with the continuous target under the PCI. Reform targets (RTs) on the legal framework for a risk-based approach to AML/CFT supervision was implemented with a minor delay (in April against the targeted date of end-March) and the legal framework to strengthen entity transparency was partially implemented in April,<sup>4</sup> but the other 5<sup>th</sup> review RTs were delayed : operational and governance assessment of Air Seychelles will be submitted to the Cabinet by end-July while the authorities proposed that a policy framework paper for Basel II pillar 1 and Basel III capital definition will be submitted to the Cabinet in June 2021 (Table 4). The government is currently discussing the future of Air Seychelles with the other shareholder with a view to minimize fiscal risks potentially arising from the company's financial difficulties.

**5. Given the significant uncertainty to the economic outlook and policy making, it is not feasible to complete the 5<sup>th</sup> review.** Due to the tremendous changes in the outlook and the uncertainty surrounding financing assurances at the time when a 5<sup>th</sup> review mission should have

<sup>4</sup> To fully implement this RT, the authorities would have to further the reform on the publication and access to the beneficial ownership information of legal entities and legal arrangements created in Seychelles.

taken place (end May/ early June 2020) as well as the large uncertainties for the rest of year with possible implications for policy making, it was not possible to conclude the 5<sup>th</sup> review by the deadline (July 31). In this context, policy discussions will continue in the period ahead and during the 6<sup>th</sup> and final review before the PCI expires in December 2020.

**6. The heavy toll of the pandemic has pushed the fiscal targets for end-June 2020 out-of-reach but progress in other areas continues to be made.**

PCI targets for the 6<sup>th</sup> review were set at the time of the 4<sup>th</sup> review: pre-pandemic. Due to the large negative impact of the COVID-19 pandemic on fiscal revenue and the mitigating expenditures to address the economic and social fallout of the pandemic, the end-June 2020 (6<sup>th</sup> review test date) QT on fiscal primary surplus is likely to be missed by a significant margin. Preliminary data indicate that the end-June 2020 QT on NIR was met with a comfortable margin while inflation at end-June 2020 was within the inner bound of the MPCC. Progress on 6<sup>th</sup> review RTs is in line with the understandings reached at the time of the 4<sup>th</sup> review, except for draft legislation for crisis management, bank resolution and safety nets<sup>5</sup>. Meanwhile, the government has been submitting monthly reports of the emergency spending on wage subsidies, health, and social spending to Finance Public Accounts Committee (FPAC) of the National Assembly in line with the commitment under the RFI. The authorities are committed to undertaking an independent audit of emergency spending and related procurement processes and publishing its results.

**7. Looking ahead, the authorities would need to identify fiscal saving measures to shore up medium-term fiscal consolidation in view of the substantial risks to debt sustainability.**

The end-2020 primary fiscal balance and public debt-to-GDP ratio are expected to deteriorate further compared with those presented at the time of the RFI request due to a further deterioration in the outlook (see ¶2). After the pandemic shock abates, however, measures should be taken to improve the primary fiscal balance from 2021 onwards, broadly in line with those illustrated at the time of the RFI request. Thus, the public debt-to-GDP ratio would steadily decline from over 90 percent at end-2020 to around 65 percent by 2025. At the time of the RFI request, debt was assessed to be “sustainable but with significant risk”. Since then, significant risks have materialized, with a sharp increase in the public debt ratio, substantial gross financing needs, downward revision in the growth outlook, and uncovered financing gaps from 2021 onwards. As a result, risks to debt sustainability have heightened further absent commitment for additional support from development partners and greater domestic action. The authorities would need to seek additional external budget support from 2021 onwards and ambitious fiscal consolidation and structural reforms.<sup>6</sup> The authorities intend to continue discussions with staff on the forthcoming draft 2021 budget, the medium-term fiscal consolidation path, and measures to enhance revenue and reduce non-priority current expenditure to be implemented from 2021 onwards in the context of the 6<sup>th</sup> review. Furthermore, structural reforms to reduce fiscal risks arising from Air Seychelles, improve public

<sup>5</sup> The authorities decided to postpone this RT to 2021 given the shift of staff priority brought by the pandemic.

<sup>6</sup> In the macro framework of this paper, unidentified external budget support loans of \$50 million in 2021 and \$30 million each year during 2022–25 are assumed.

investment efficiency, and to enhance medium-term growth prospects could be envisaged. A full DSA will be a prerequisite for the completion of the 6th review.

**Box 1. Continuous Targets**

- Not to impose or intensify restrictions on the making of payments and transfers for current international transactions
- Not to introduce or modify multiple currency practices
- Not to conclude bilateral payments agreements that are inconsistent with Article VIII
- Not to impose or intensify import restrictions for balance of payments reasons

Table 1. Seychelles: Selected Economic and Financial Indicators, 2016–25

Nominal GDP (2017): US\$1,498 million

Per capita GDP (2017): US\$15,735

Population, end-year (2016): 94,677

Literacy rate (2015): 95.3 percent

Main products and exports: Tourism, Canned Tuna

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Act.	Act.	Prel.	Proj.				Proj.		
(Annual percent change, unless otherwise indicated)										
<b>National income and prices</b>										
Nominal GDP (millions of Seychelles rupees)	19,002	20,806	22,064	23,191	20,724	22,234	24,075	25,995	27,891	29,865
Real GDP	4.6	4.4	3.8	3.9	-13.8	4.2	5.5	4.8	4.2	4.0
CPI (annual average)	-1.0	2.9	3.7	1.8	3.9	2.9	2.9	3.0	3.0	3.0
CPI (end-of-period)	-0.2	3.5	3.4	1.7	6.6	3.0	2.9	3.0	3.0	3.0
GDP deflator average	-0.9	4.9	2.2	1.2	3.6	3.0	2.6	3.0	3.0	3.0
<b>Money and credit</b>										
Broad money	12.1	16.4	7.7	13.9	-6.3	...	...	...	...	...
Reserve money (end-of-period)	14.5	18.9	4.5	22.7	-6.4	...	...	...	...	...
Velocity (GDP/broad money)	1.4	1.3	1.3	1.2	1.1	...	...	...	...	...
Money multiplier (broad money/reserve money)	4.6	4.5	4.6	4.3	4.3	...	...	...	...	...
Credit to the private sector	10.3	17.8	11.5	22.3	10.5	...	...	...	...	...
(Percent of GDP, unless otherwise indicated)										
<b>Savings-Investment balance</b>										
External savings	20.6	20.1	17.9	16.7	27.0	25.3	23.8	21.3	19.3	18.6
Gross national savings	9.7	8.8	8.6	9.5	-1.9	4.2	5.4	7.9	8.4	9.1
Of which: government savings	3.8	3.7	4.2	4.4	-13.6	-4.6	-0.8	2.8	3.7	4.8
private savings	5.9	5.0	4.4	5.1	11.7	8.8	6.3	5.2	4.7	4.3
Gross investment	30.2	28.9	26.6	26.2	25.2	29.4	29.3	29.2	27.7	27.7
Of which: public investment <sup>1</sup>	5.0	4.4	5.1	3.7	5.2	6.4	5.8	5.7	5.7	5.7
private investment	25.2	24.5	21.5	22.5	20.0	23.0	23.5	23.5	22.0	22.0
Private consumption	47.1	51.3	52.7	53.1	49.6	51.3	53.0	52.1	52.2	52.4
(Percent of GDP)										
<b>Government budget</b>										
Total revenue, excluding grants	36.7	35.1	36.2	36.0	31.7	32.9	33.1	33.9	33.8	33.7
Expenditure and net lending	38.1	36.5	37.8	36.1	51.2	44.8	40.5	39.0	37.2	35.7
Current expenditure	33.1	32.1	32.8	32.4	46.1	38.4	35.8	33.5	32.2	30.7
Capital expenditure <sup>1</sup>	5.0	4.4	5.1	3.7	5.1	6.5	5.8	5.7	5.0	5.1
Overall balance, including grants	-1.4	0.1	0.7	-0.8	-16.1	-7.1	-5.2	-3.2	-2.1	-0.8
Program primary balance	3.4	3.1	2.9	2.7	-12.2	-3.3	-1.7	0.0	1.6	2.5
Total government and government-guaranteed debt <sup>2</sup>	72.7	65.8	60.9	59.1	93.1	89.9	84.7	77.4	71.4	64.9
Domestic (including debt issued for monetary purposes)	40.5	36.2	32.3	32.1	46.0	45.3	42.5	39.2	35.3	29.6
of which: Monetary debt	16.2	11.2	9.2	8.6	8.2	6.3	4.5	3.1	1.8	1.0
External	32.2	29.7	28.5	27.0	47.2	44.6	42.2	38.2	36.2	35.3
<b>External sector</b>										
Current account balance including official transfers (in percent of GDP)	-20.6	-20.1	-17.9	-16.7	-27.0	-25.3	-23.8	-21.3	-19.3	-18.6
Total external debt outstanding (millions of U.S. dollars) <sup>3</sup>	1,505	1,639	1,762	1,875	1,842	1,921	2,010	2,099	2,172	2,200
(percent of GDP)	105.5	107.5	111.6	113.6	153.7	154.9	141.5	130.1	121.3	114.8
Terms of trade (=deterioration)	-13.7	-2.8	-3.3	6.7	12.7	-2.7	-0.7	-0.1	0.2	0.2
Real effective exchange rate (average, percent change)	-0.1	-3.2	...	...	...	...	...	...	...	...
Gross official reserves (end of year, millions of U.S. dollars)	522.6	546	548	580	354	389	425	483	524	577
Months of imports, c.i.f.	3.7	3.5	3.6	6.1	2.9	2.8	2.8	3.0	3.1	3.2
In percent of Assessing Reserve Adequacy (ARA) metric	131.0	129.3	122.9	129.5	99.2	100.7	103.5	109.2	118.6	124.0
<b>Exchange rate</b>										
Seychelles rupees per US\$1 (end-of-period) <sup>4</sup>	13.5	13.8	14.0	14.1	18.1	...	...	...	...	...
Seychelles rupees per US\$1 (period average) <sup>4</sup>	13.3	13.6	13.9	14.0	16.0	...	...	...	...	...

Sources: Central Bank of Seychelles; Ministry of Finance; and IMF staff estimates and projections.

<sup>1</sup> Includes onlending to the parastatals for investment purposes.<sup>2</sup> Includes debt issued by the Ministry of Finance for monetary purposes.<sup>3</sup> Includes private external debt.<sup>4</sup> As to 2020, exchange rate measured as of July 14, 2020.

Table 2. Seychelles: Quantitative Targets (QTs) Under the PCI, December 2019 – December 2020

	2019						2020			
	June			December			June		December	
	QT			QT				QT	Projection	
	3rd Review	Act.	Status	4th Review	Act.	Status	Proposed	Prel. Status	Projection	
<b>Quantitative Targets</b>										
Net international reserves of the CBS, millions of U.S. dollars (floor) <sup>1</sup>	396	409	Met	403	430	Met	402	440	Met	208
Primary balance of the consolidated government (cumulative floor)	265	254	Not Met	584	615	Met	211	N.A.		-2,538
Accumulation of external payments arrears by the public sector (ceiling) <sup>3</sup>	0.0	0.0	Met	0.0	0.0	Met	0.0	0.0	Met	0.0
<b>Monetary Policy Consultation Clause <sup>4</sup></b>										
Inflation (mid-point, percent) <sup>5</sup>	2.8	2.7		1.8	1.8		1.8	1.0		3.9
Inflation (upper bound, percent) <sup>5</sup>	4.8			3.8			3.8			5.9
Inflation (lower bound, percent) <sup>5</sup>	0.8			-0.2			-0.2			1.9
Inflation (upper inner-bound, percent) <sup>5</sup>	4.3			3.3			3.3			5.4
Inflation (lower inner-bound, percent) <sup>5</sup>	1.3			0.3			0.3			2.4
<b>Memorandum items:</b>										
Nominal public debt (millions of Seychelles Rupees, ceiling) <sup>1,2</sup>	13,301	13,001		14,257	13,361		14,352	N.A.		17,117
<b>Program accounting exchange rates <sup>6</sup></b>										
SR/US\$ (end-of-quarter)		14.02			14.06		14.06			14.06
US\$/Euro (end-of-quarter)		1.14			1.10		1.10			1.10
US\$/UK pound (end-of-quarter)		1.33			1.22		1.22			1.22
US\$/AUD (end-of-quarter)		0.71			0.67		0.67			0.67
US\$/CAD (end-of-quarter)		0.76			0.75		0.75			0.75
US\$/CNY (end-of-quarter)		0.15			0.14		0.14			0.14
US\$/SDR (end-of-quarter)		1.40			1.37		1.37			1.37
Sources: Seychelles authorities; and IMF staff estimates and projections.										
<sup>1</sup> Measured at program accounting exchange rate. The NIR floor is adjusted as defined in the TMU. End-June 2019 target is adjusted downward by \$7 million due to the shortfall of receipts from sales of Cable and Wireless Company, in accordance with TMU.										
<sup>2</sup> Nominal public debt includes government guarantees.										
<sup>3</sup> The nonaccumulation of new external payment arrears constitutes a standard continuous target. Excludes arrears for which a rescheduling agreement is sought.										
<sup>4</sup> When the end of period annual average headline inflation is above/below the upper/lower bound, a formal consultation with the Executive Board would be triggered.										
<sup>5</sup> Average of year-on-year headline inflation for the past 12 months.										
<sup>6</sup> Program exchange rates have been set according to prevailing market rates at the latest available update.										

Table 3. Seychelles. Reform Targets Under the PCI, 2019–20

Actions	Timing	Objective/Status
<b>State-Owned Enterprises (SOEs)</b>		
Submit the amendments on Public Enterprise Monitoring Committee (PEMC) Act to the Cabinet to strengthen enforcement power of PEMC.	End September 2019 (4 <sup>th</sup> review)	Not met. To be implemented in September 2020.
Submit operational and governance assessments of Air Seychelles to the Cabinet.	End December 2019 (5 <sup>th</sup> review)	Not met. To be implemented in July 2020.
<b>Business environment</b>		
Submit the policy paper on the draft amendments to the Companies Act and Insolvency Act to the Cabinet.	End September 2020 (6 <sup>th</sup> review)	Improve Business environment. On track to be implemented on time.
<b>Financial Sector Stability</b>		
Submit to the Cabinet amendments to legal framework that allows to implement a risk-based approach to the supervision of banks and trusts and company service providers, consistent with the FATF standard.	End-March 2020 (5 <sup>th</sup> review)	Not met. It was implemented in April 2020.
Submit draft legislation for crisis management, bank resolution, and safety nets to the Cabinet.	End-November 2020 (6 <sup>th</sup> review), reset from end-March 2020	Will be delayed to November 2021.
Submit a policy framework paper for an implementation of Basel II pillar 1 and Basel III capital definition to the Cabinet.	End-December 2019 (5 <sup>th</sup> review)	Will be delayed to end-June 2021.
Submit a policy framework paper on Financial Stability Act to the Cabinet to assign macro prudential power to relevant institutions.	End-September 2020 (6 <sup>th</sup> review)	Strengthen macro prudential framework. On track to be implemented on time.
Submit amendments to the Cabinet to the legal framework to strengthen entity transparency (including on basic and beneficial ownership information on the domestic companies and international financial services companies and the establishment of a master registry of beneficial owners) in line with the FATF standard and the IMF's capacity development recommendations.	End-March 2020 (5 <sup>th</sup> review)	Not met. It was partially implemented in April 2020.